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BEFORE THE PUBLIC UTILITIES COMMISSION

OF THE STATE OF HAWAII

In the Matter of the Application of)
)
HAWAIIAN ELECTRIC COMPANY, INC.,)
HAWAII ELECTRIC LIGHT COMPANY, INC.,)
and MAUI ELECTRIC COMPANY, LIMITED) DOCKET NO. 03-0257
)
For Exemption From and Modification)
of General Order No. 7,)
Paragraph 2.3(g), Relating to)
Capital Improvements.)

DECISION AND ORDER NO. 21002

Filed May 27, 2004
At 10:00 o'clock A .M.

Karen Higashi

Chief Clerk of the Commission

TABLE OF CONTENTS

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In the Matter of the Application of HAWAIIAN ELECTRIC COMPANY, INC., HAWAII ELECTRIC LIGHT COMPANY, INC., and MAUI ELECTRIC COMPANY, LIMITED For Exemption From and Modification of General Order No. 7, Paragraph 2.3(g), Relating to Capital Improvements.	Docket No. 03-0257 Decision and Order No. 21002

DECISION AND ORDER

I.

Background

HAWAIIAN ELECTRIC COMPANY, INC. ("HECO"), HAWAII ELECTRIC LIGHT COMPANY, INC. ("HELCO"), and MAUI ELECTRIC COMPANY, LIMITED ("MECO")(collectively, "Applicants" or "Utilities"), seek to increase the monetary threshold that triggers the filing of capital expenditure applications with the commission, from $500,000 to $3 million, exclusive of customer contributions.[1] Applicants make their request pursuant to paragraphs 1.2(b) and 2.3(g)2 of General Order No. 7, *Standards for Electric Utility Service* ("GO No. 7").

Applicants served copies of their application upon the Department of Commerce and Consumer Affairs, Division of Consumer Advocacy ("Consumer Advocate")(collectively, the "Parties"). The Consumer Advocate does not object to Applicants'

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[1]Utilities' application, filed on September 12, 2003.

request, subject to certain conditions.[2] In response to said conditions, the Parties entered into a stipulation, filed on May 5, 2004.

II.

Applicants' Request

HECO, HELCO, and MECO are the duly franchised public utilities and providers of electric service for the islands of Oahu and Hawaii, and the County of Maui, respectively.

GO No. 7, paragraph 1.2(b), provides:

> If unreasonable hardship to a utility or to a customer results from the application of any rule herein prescribed, application may be made to the Commission for the modification of the rule or for temporary or permanent exemption from its requirements.

Pursuant to paragraph 1.2(b), above, Applicants seek a permanent exemption from certain provisions of GO No. 7, paragraph 2.3(g)2, by modifying paragraph 2.3(g)2 to read as follows:[3]

> Proposed capital expenditures for any single project related to plant replacement, expansion or modernization, in excess of **[**$500,000**]** **<u>$3,000,000, excluding customer contributions,</u>** or 10 per cent of the total plant in service, whichever is less, shall be submitted to the Commission for review at least 60 days prior to the commencement of construction or commitment for expenditure, whichever is earlier.

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[2]Consumer Advocate's position statement, filed on December 23, 2003.

[3]Proposed deletion bracketed, proposed additions underscored.

In essence, Applicants seek to modify paragraph 2.3(g)2, as applied to them, by: (1) increasing the dollar threshold governing capital expenditure applications, from $500,000 to $3 million; and (2) excluding customer contributions from the calculation of the dollar threshold.

In support thereto, Applicants state:

1. The proposed increase recognizes the effect of inflation since 1965, when GO No. 7 was promulgated.[4] By increasing the threshold, the commission will restore the application of paragraph 2.3(g)2 to its original intent.

2. The reasonableness of increasing the threshold is confirmed when examining paragraph 2.3(g)2's second threshold -- ten (10) per cent of HECO's total plant-in-service.

   Specifically, at the end of 2002, HECO's plant-in-service was more than ten (10) times the plant-in-service level at the end of 1965. Thus, if the same ten (10) per cent factor is applied to the $500,000 threshold established in 1965, the current threshold in 2002 dollars would be at least $5,000,000.

3. The primary benefit of increasing the threshold is the expected reduction in the number of capital projects that will require the commission's approval.

   Specifically, if the threshold is increased, as proposed:

   A. Only one (1) of the eight (8) capital expenditure projects submitted by Applicants

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[4]Applicants estimate that $500,000 in 1965 dollars is worth: (1) $2,620,000 in 2002 dollars, based on the Honolulu Consumer Price Index for Urban Customers ("CPI-U"); and (2) $2,855,000 in 2002 dollars, based on the United States CPI-U.

They then deduce that "[t]he range of $2.6 million to $2.9 million is somewhat understated, given the 1965 dollar value is updated to 2002 dollars, rather than to 2003 dollars. Therefore it is reasonable to increase and round the threshold to $3,000,000 to more closely reflect the operating environment expected in 2003 and future years." Utilities' application, at 4.

in 2002 would have required the commission's prior approval;[5] and

B. Twelve (12) of the sixteen (16) major capital expenditure projects submitted by Applicants thus far in 2003 would not require the commission's approval.

"While the number of applications will decrease, the cost of higher profile projects, such as the addition of new generation units and transmission lines, would be well over the proposed $3,000,000 threshold, and will still require Commission approval."[6]

4. The commission, Consumer Advocate, Applicants, and their ratepayers will benefit from the reduction in the number of filings that the modification should achieve, resulting in the more efficient use of available resources, and speed the deployment of capital improvement projects.

5. Since the portion of a capital project's cost that is funded by customer contributions offsets, in whole or in part, the increase in plant-in-service additions, the threshold should not include the capital costs to the extent such costs are customer-funded.

Moreover, "there is a negative deferred income tax effect due to the capitalization of the tax liability related to the customer contributions."[7]

6. The current $500,000 threshold constitutes an "unreasonable hardship" upon Applicants.

Specifically, paragraph 2.3(g)2:

A. Requires HECO, HELCO, and MECO to submit applications for commission approval of relatively small capital expenditure projects that were never intended for commission review, but which must now be reviewed as a result of inflation over the years.

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[5]Applicants' diagram of "Capital Expenditure Applications Submitted" for the years 1998 to August 31, 2003 is attached as Exhibit II, page 1, to the application.

[6]Utilities' application, at 5.

[7]Id. at 6.

B. Applies to and can unreasonably delay the commencement of customer-initiated projects that will be paid for by the customer but will not significantly impact rate base.

7. Its proposed relief through adjudication is proper.[8]

III.

Consumer Advocate's Position

The Consumer Advocate notes that Applicants primarily rely upon the increase in the CPI-U between 1965 and 2002 as justification for their request to increase the threshold to $3 million. The Consumer Advocate states that the increase in the CPI-U should not be the sole basis for supporting an increase in the capital expenditure threshold because there is no direct relationship between the change in the CPI-U and the change in the cost of providing utility service. Specifically, the CPI-U does not necessarily reflect the cost of goods and services purchased by an electric utility company.

That said, the Consumer Advocate finds reasonable Applicants' request to increase the threshold from $500,000 to $3 million, exclusive of customer contributions, subject to two (2) conditions. The Consumer Advocate examined a number of factors in finding the proposed $3 million threshold reasonable, including: (1) the impact of the $3 million threshold on each utility's plant in service balance; (2) the projected decrease in capital expenditure applications resulting from the $3 million threshold; (3) the proper balance in selecting a reasonable

[8]See Order No. 12223, filed on March 12, 1993, at 5 - 6, in Dockets No. 7300 and 7317 (consolidated).

threshold amount; and (4) the regulators' on-going review of Applicants' respective Integrated Resource Plans ("IRP").

A.

Plant in Service Balance

The existing threshold is $500,000 or ten (10) per cent of the total plant in service, whichever is less, pursuant to GO No. 7, paragraph 2.3(f)2. The Consumer Advocate states that the existing threshold was established to provide the commission the opportunity to review projects that were expected to impact a utility's rate base and revenue requirements in future rate proceedings.

The Consumer Advocate finds that: (1) in 1965, $500,000 represented approximately 0.26, 1.83, and 3.57 per cent of the plant in service balances for HECO, HELCO, and MECO, while ten (10) per cent of their year-end balances were $19.6 million, $2.7 million, and $1.4 million, respectively; and (2) in 2002, $500,000 represented approximately 0.02, 0.09, and 0.08 per cent of the plant in service balances for HECO, HELCO, and MECO, while ten (10) per cent of their year-end balances were $204.8 million, $56.9 million, and $59.8 million, respectively. Thus, over the years, the impact of a $500,000 capital expenditure project on the total plant in service balance has significantly decreased. In particular, in 2002, a $500,000 project increased rate base by a nominal 0.09 per cent or less.

In examining the impact of the proposed $3 million threshold on Applicants' respective plant in service balances, the Consumer Advocate notes that "[t]he proposed capital expenditure filing threshold of $3 million represents less than 1.0% for each of the Company's reported total plant in service balance as of September 2003. This percentage is less than the relative percentage of a $500,000 capital project in the 1965 timeframe."[9]

B.

Capital Expenditure Applications

The Consumer Advocate notes that, had the $3 million threshold been in place during the ten (10)-year period from 1993 to 2002, the number of capital expenditure applications filed by Applicants would have decreased from one-hundred twenty-seven (127) to one-hundred eight (108). Raising the threshold to $3 million should reduce the regulatory work for Applicants, as it relates to capital expenditure applications.

C.

"Reasonable Balance"

The Consumer Advocate states that the purpose of the capital expenditure filing requirement is to "reduce the regulatory review conducted on the utility's plant in service balance in a rate proceeding."[10] Specifically, if the regulatory review process is conducted in years between rate case filings,

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[9]Consumer Advocate's position statement, at 10.

[10]Id. at 10 - 11.

the regulatory agencies' workload will be better distributed and their review of rate applications could be completed expeditiously. Thus, the threshold should represent a proper balance that reflects a reasonable percentage of the utility's annual plant additions that are subject to the regulators' pre-rate case review.[11]

The Consumer Advocate concedes that the benefits of reviewing every utility capital addition are outweighed by the cost of performing such a review. Ultimately, it concludes that the proposed $3 million threshold (exclusive of customer contributions) represents a reasonable balance, provided that the commission adopts two (2) conditions, discussed below.

D.

Two (2) Reporting Conditions

The Consumer Advocate explains that a public utility under rate of return regulation is generally precluded from increasing its revenues unless the utility's authorized rate of return or rate base is allowed to increase. Thus, Applicants' ratepayers need assurances that the capital expenditures included in rate base are reasonable for ratemaking purposes, regardless of the cost of the capital projects. To ensure that Applicants'

[11]In achieving this balance, the Consumer Advocate maintains that "[t]he threshold should not be set too high, thereby allowing the utility to proceed with major projects that are not subject to regulatory review before being placed in service. On the other hand, the threshold should not be set so low that the regulator is reviewing projects that are routine and necessary for the provision of the utility service." Id. at 11.

consumers are properly protected, the Consumer Advocate urges the adoption of the following two (2) conditions:

1. Require Applicants to include more information on the projects referenced in their five (5)-year projected capital improvements budget report annually filed with the commission by December 31st, with particular emphasis on the projects planned for the upcoming year.[12] The Consumer Advocate proposes that the report include: (A) a brief description of each project listed for the upcoming year and a statement as to the primary reasons for the project; and (B) a brief explanation of how the project relates to the overall operational objectives of Applicants' management. Following the filing of Applicants' report, the Consumer Advocate requests that Applicants make a presentation to the commission and Consumer Advocate and provide an opportunity to discuss the projects.

2. Require Applicants to file, by May 31st of the subsequent calendar year, a report containing a narrative list of the projects completed during the preceding year. Specifically, the Consumer Advocate proposes a tri-level reporting system, based on the completed project's total cost:

A. *Completed Projects with a Total Cost of Less Than $500,000*. Provide the total number of projects completed and the total cost associated with these projects.

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[12]GO No. 7, paragraph 2.3(g)(1), requires Applicants to annually file with the commission, by the end of each calendar year, a report on Applicants' "projected capital improvements program expenditures budget for the ensuing five years which shall include, in considerable detail, the capital improvements program expenditures budget approved by management for the first year of the five-year period."

B. *Completed Projects with a Total Cost Between $500,000 to Under $3 Million.* Itemize each completed project with the actual costs incurred, with an explanation of any deviations of plus or minus ten (10) per cent from the budgeted cost, and a general discussion of the reasons causing the variance.

C. *Completed Projects with a Total Cost of $3 Million or More.* Identify each completed project and its total cost.

E.

Integrated Resource Plan

The Consumer Advocate posits that the information Applicants provide in these reports, together with the regulators' on-going review of Applicants' IRP, should provide the commission and Consumer Advocate the opportunity to assess the reasonableness of the plant additions in years between rate proceedings. The Consumer Advocate explains that the IRP process provides a means by which to evaluate the need for proposed capital expenditures. And "while the review conducted in the IRP should not negate the need for the capital expenditure review process, the IRP process can provide some overall assurances regarding the need for the capital expenditures for plant."[13]

[13] Consumer Advocate's position statement, at 14 - 15.

IV.

Utilities' Response

In response to the Consumer Advocate's proposed conditions, Applicants entered into a stipulation with the Consumer Advocate. By their stipulation, the Parties agree to:

1. Modify the Consumer Advocate's first condition by applying the additional information requirement to projects that are expected to cost $1 million or more "with expenditures expected for the upcoming year[.]"[14]

2. Modify the Consumer Advocate's second condition by: (A) increasing the $500,000 amount to $1 million; (B) clarifying that the scope of the "less than $1 million" total cost category applies to plant additions; and (C) changing the ten (10) per cent deviation to fifteen (15) per cent. Thus, Condition No. 2(A) and (B) will now read:[15]

> *A. [Completed Projects]* ***Plant Additions*** *with a Total Cost of Less Than* ***[$500,000]*** ***$1 Million.*** Provide the total number of projects completed and the total cost associated **[**with these projects.**]** **by asset category for those plant additions.**
>
> *B. Completed Projects with a Total Cost Between* ***[$500,000]*** ***$1 Million*** *to Under $3 Million.* Itemize each completed project with the actual costs incurred, with an explanation of any deviations of plus or minus

[14]Parties' stipulation, at 4.

[15]Proposed deletions bracketed, proposed additions underscored.

[ten (10)] **<u>fifteen (15)</u>** per cent from the budgeted cost, and a general discussion of the reasons causing the variance.

C. Completed Projects with a Total Cost of $3 Million or More. Identify each completed project and its total cost.

The Parties also agree to "continue [their] discussions to reach consensus on an acceptable presentation format for the capital budget and narrative list/schedule/report."[16]

V.

Discussion

The Consumer Advocate's position statement and the Parties' joint response thereto ultimately represent an agreed-upon stipulation between them. The commission reviews the overall reasonableness of the Parties' agreement.

In general, this commission's analysis of capital expenditure applications involves a review of whether the project and its costs are reasonable and consistent with the public interest, among other factors. If the commission approves the utility's application, the commission in effect authorizes the utility to commit funds for the project, subject to the proviso that "no part of the project may be included in the utility's rate base unless and until the project is in fact installed, and is used and useful for public utility purposes."

[16]Parties' stipulation, at 5.

Undoubtedly, the cost of materials, supplies, equipment, and labor utilized in electric utility capital expenditure projects has increased in the forty (40) years since the $500,000 threshold was initially established. The commission is not convinced, however, that an increase to $3 million is justified at this juncture. The commission's interpretation of Applicants' cost data does not support a $3 million threshold. Rather, using Applicants' lower range of $2.6 million, the commission rounds downward, to $2.5 million.

The commission finds that $2.5 million, exclusive of customer contributions, reflects a reasonable balance that will enable the commission and Consumer Advocate to:

1. Continue their review of capital expenditures for major projects, including those projects that involve great public interest or controversy; and

2. Review such projects during the interim period between a utility's rate case filings, where, in the Consumer Advocate's words, "the work of the regulatory agencies would be better distributed and the review of the [utility's resulting] rate application could be completed expeditiously."[17]

In addition, the Parties' agreed upon annual tri-level reporting system, due by May 31st of each subsequent calendar year, together with the additional information included in Applicants' respective five (5)-year budget reports, and their resulting annual, oral presentation, will aid the commission in

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[17]Consumer Advocate's position statement, at 9.

its on-going review of Applicants' respective regulated utility operations.

The commission approves the Parties' agreement, subject to certain changes:

1. Adopting a $2.5 million threshold in lieu of the Parties' proposed $3 million threshold.[18]

2. For Applicants' respective five (5)-year projected capital improvements budget reports, the additional information shall also include: (A) a brief explanation of how the project is consistent with Applicants' IRP; and (B) a projected timeline, i.e., the project's estimated start and completion dates, for each project that is budgeted for, or referenced in the respective reports.

3. Applicants' presentation to the commission and Consumer Advocate shall include a description of the status of on-going projects in excess of $1 million or more.

The commission modifies GO No. 7, paragraph 2.3(g)(2), by inserting the phrase "$2.5 million, excluding customer contributions," in place of the current "$500,000" threshold. The commission reserves the right to rescind, adjust, or amend this modification in the future, consistent with the public interest.

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[18]With the $2.5 million threshold, the scope of the Parties' agreed upon Condition No. 2(B) and (C) will also change. To wit: (1) Condition No. 2(B) will change from *Completed Projects with a Total Cost Between $1 Million to Under $3 Million*, to *Completed Projects with a Total Cost Between $1 Million to Under **$2.5 Million***; and (2) Condition No. 2(C) will change from *Completed Projects with a Total Cost of $3 Million or More*, to *Completed Projects with a Total Cost of **$2.5 Million** or More*.

VI.

Orders

THE COMMISSION ORDERS:

1. The Parties' agreement is approved, as modified by the commission.

2. Effective July 1, 2004, and no sooner, as applied to Applicants, GO No. 7, paragraph 2.3(g)(2), is modified by inserting the phrase "$2.5 million, excluding customer contributions," in place of the "$500,000" threshold. The commission reserves the right to rescind, adjust, or amend this modification in the future, consistent with the public interest.

3. Applicants shall include additional information on the projects referenced in their respective five (5)-year projected capital improvements budget reports annually filed with the commission by December 31st, with particular emphasis on the projects planned for the upcoming year. Specifically, the additional information shall include: (A) a brief description of each project that is expected to cost $1 million or more with expenditures expected for the upcoming year, and a statement as to the primary reasons for the project; and (B) a brief explanation of how the project relates to the overall operational objectives of HECO, HELCO, and MECO's management, and is consistent with their respective IRP. In addition, the respective reports shall include a projected timeline, i.e., the project's estimated start and completion dates, for each project that is budgeted for, or referenced in each report.

Following the filing of the respective reports, Applicants shall make a joint presentation or separate presentations to the commission and Consumer Advocate. Said presentation shall include a description of the status of on-going projects in excess of $1 million or more.

4. Applicants shall each file, by May 31st of each subsequent calendar year, a report containing a narrative list of the projects completed during the preceding year, as follows:

A. *Plant Additions with a Total Cost of Less Than $1 Million.* Provide the total number of projects completed and the total cost associated by asset category for those plant additions.

B. *Completed Projects with a Total Cost Between $1 Million to Under $2.5 Million.* Itemize each completed project with the actual costs incurred, with an explanation of any deviations of plus or minus fifteen (15) per cent from the budgeted cost, and a general discussion of the reasons causing the variance.

C. *Completed Projects with a Total Cost of $2.5 Million or More.* Identify each completed project and its total cost.

5. Applicants shall conform to all of the commission's orders set forth above. The failure to adhere to the commission's orders shall constitute cause for the commission to void this decision and order, and may result in further regulatory action as authorized by law.

DONE at Honolulu, Hawaii this 27th day of May, 2004.

PUBLIC UTILITIES COMMISSION
OF THE STATE OF HAWAII

By Carlito P. Caliboso
Carlito P. Caliboso, Chairman

By Wayne H. Kimura
Wayne H. Kimura, Commissioner

By Janet E. Kawelo
Janet E. Kawelo, Commissioner

APPROVED AS TO FORM:

Michael Azama
Michael Azama
Commission Counsel

03-0257.sl

CERTIFICATE OF SERVICE

I hereby certify that I have this date served a copy of the foregoing Decision and Order No. 21002 upon the following parties, by causing a copy hereof to be mailed, postage prepaid, and properly addressed to each such party.

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